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Nicholas Waterhouse

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By Sir Nicholas Waterhouse

All of you are no doubt familiar with those fascinating mystery stories at the end of which the brilliant amateur detective confounds the painstaking inspector by pointing to the perpetrator of the crime and at the same time to some small step which the inspector might have taken and thereby have placed himself on the sure road to discovery. When this dénouement occurs it counts for nothing that the inspector has taken all those steps which experience has shown to be most likely to result in detection of such a crime as has been committed, nor is it deemed relevant that to have taken all the unlikely steps, one of which, as it turns out, would have resulted in discovery, would have necessitated the employment of men and time to an extent far beyond his resources. He is left to bear with what equanimity he can command the tolerant superiority of the amateur and the more open scorn of the minor characters in the story.

The feelings aroused in readers of such tales vary—some are lost in admiration of the achievements of the brilliant amateur; others feel a certain sympathy with the criminal whose well-laid plans have been frustrated by the combination of a seemingly inconsequential error and the uncanny intuition of his nemesis; few waste any sympathy upon the discomfited inspector. But among those few (if it be true that a fellow feeling makes us wondrous kind) should be found those readers who happen to be professional auditors of accounts. For if they have been so fortunate as to enjoy a considerable practice, they are almost certain to be reminded of occasions on which they have vainly attempted to explain the fact that a defalcation undiscovered by them has been perpetrated in connection with accounts which have been subjected to their audit. At such a time the sufferer from the defalcation is apt to be unable to see anything except the one fact that an apparently simple step, involving perhaps no great amount of work, would have led to the detection of the fraud. Patiently, but with small hope of success, the auditor explains that the steps which he did take would in ninety-nine out of a hundred cases be

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more likely to prove effective, and that if he had done all the many things that might possibly have unearthed the defalcation, the scope and extent of the audit would have been extended beyond all reason. Delicately he points out things which the client himself or his staff might have done which would have made such a defalcation impossible or resulted in its discovery.

The analogy is not perfect. In the mystery story it is not suggested that the unsuccessful inspector should be cast in pecuniary damages for his failure or even that he should lose his position. The auditor is lucky if he is not confronted with both these suggestions.

In justice to one's clients let me say that many of them, when satisfied that the auditor has served them loyally and carried out his duties conscientiously, are willing to take a reasonable view of such a case. There are, however, exceptions, particularly in those cases where to absolve the auditor from blame is to imply that the directors themselves were negligent, or where the fraudulent employee has been the subject of a fidelity bond and the insurer refuses to accept liability until it has been proved that the auditor has not been negligent. The professional auditor is then at a distinct disadvantage and the case is made more delicate and difficult for him by the fact that his principal asset is his reputation and that resistance to the claim may result in damage to that reputation, whether or not it results in a pecuniary liability.

Now, the lawyers may tell us that this is wholly a matter of contract, express or implied, and that it is for the accountant to see that the respective rights and obligations of his clients, the insurers and himself are defined to his satisfaction. I think that in cases in which the auditor is retained expressly to make an internal audit it is possible at the time of making the contract to define his position in the unfortunate event of a defalcation taking place and escaping detection by him. And, in passing, may I say that he should not accept a contractual relationship under which he may be held pecuniarily liable if he fails to live up to the standards of effectiveness set by the heroes of detective fiction.

For the present, however, I should like to direct your attention to the narrower question which is presented when the auditor is appointed under the companies acts and assumes purely statutory obligations. Since the question has not been settled by legal decisions, and since I am not a lawyer, I am not going to undertake to define the legal position. I am going to put before you

only the view suggested by my knowledge, inherited or acquired, of the history of the law, and by my experience in the field of business as well as in that of auditing.

The protection of a company against risks of fraud by its employees, the detection of frauds which occur and the recovery of whatever reparation can be obtained, are obviously purely administrative functions. The problem of safeguarding transactions is always a matter of weighing the risks of loss against the costs of protection and, therefore, a matter lying wholly in the field of business judgment. The detection of frauds is usually most likely to be accomplished by continuous supervision which, unless the volume of business is small, can best be given by persons regularly employed for that purpose. Indeed, modern developments, and particularly the increased use of mechanical devices, while resulting in greater economy, accuracy and expedition in the field of bookkeeping, have undoubtedly made the detailed audit which is not continuous and practically contemporaneous with the transactions audited extremely difficult and expensive.

It can not, therefore, be questioned that apart from the statute the work of detecting fraud falls on the directors and on those whom they employ. Nor is there, I think, the slightest ground for a suggestion that the audit provisions of the companies acts have in any degree changed this position.

The provisions of the companies acts relating to the duties of auditors are of course familiar to you, but it may be desirable here to recall the precise language in which they are expressed in section 134 (1) of the act of 1929, as follows:

> "The auditors shall make a report to the members on the accounts examined by them, and on every balance-sheet laid before the company in general meeting during their tenure of office and the report shall state—
>
> "(a) Whether or not they have obtained all the information and explanations they have required, and
>
> "(b) Whether in their opinion the balance-sheet referred to in the report is properly drawn up so as to exhibit a true and correct view of the state of the company's affairs according to the best of their information and the explanations given to them and as shown by the books of the company."

The sole objective of the auditor's work which is indicated is the formulation by the auditor of an informed opinion on the question

whether the balance-sheet of the company exhibits a true and correct view of the state of the company's affairs. This is a far less onerous task than for the auditors to satisfy themselves as far as possible (the limitation is inescapable) whether all the transactions of the company have been faithfully recorded and all funds honestly administered.

Attempts are sometimes made to impose the more onerous responsibility on the auditor by inference. The auditor must see that the balance-sheet is exactly correct (so runs the argument) and it can not be correct unless all the transactions are correctly reflected therein: therefore the auditor must do everything in his power to satisfy himself that all the transactions are honestly and properly recorded. This argument not only overstates in its premise the express requirements of the act, but in its conclusion violates the principles which govern the construction of statutes.

If parliament had intended to impose the more onerous duty on auditors, it would have done so in express terms: it would not have defined the minor obligation and left the major obligation a matter of inference. The contrast in this respect between the general companies acts and acts such as the building societies act of 1874 or the friendly societies act, 1896, is striking and significant. Section 27 of the latter act reads in part as follows:

> "Sec. 27. Every registered society and branch shall once in every year . . . send to the registrar a return . . . of the receipts and expenditure, funds and effects of the society or branch as audited."
>
> "Sec. 26. The auditors shall have access to all the books and accounts of the society or branch, and shall examine the annual return mentioned in this act, and verify the annual return with the accounts and vouchers relating thereto, and shall either sign the annual return as found by them to be correct, duly vouched and in accordance with law, or specially report to the society or branch in what respects they find it incorrect, unvouched or not in accordance with law."

It would have been easy to embody similar language in the general company law, but this has never been done, no doubt for the simple reason that it was not necessary to the accomplishment of the purpose which parliament had in contemplation; viz., a reasonable measure of protection for members against deception or other wrongful acts on the part of directors and officers. It was

no part of this purpose to assign to the members and the auditor appointed by them duties which properly belong to the directors.

The origin and development of the audit imposed by section 134 (1) of the act of 1929, which perhaps for the sake of brevity I may allude to hereafter as the "official" audit, is fairly summarized in Spicer & Pegler's *Practical Auditing*, 3rd edition, page 13, as follows:

"The fact that the whole control of the company was vested in the directors rendered it necessary that some means should be utilized of enabling the shareholders to be assured that the accounts presented to them by the board correctly represented the state of affairs of the company and that the directors had not utilized their position for the purpose of misappropriating the funds of the company or using them for their private gains. It was impracticable however for every individual shareholder to satisfy himself on these points, for as a rule he was not possessed of the requisite technical knowledge and the right of inspection and enquiry could not be given to one shareholder without it being granted to all. Consequently, it became usual for shareholders to appoint one or more of their number to act as auditor or auditors of the company and to report to the shareholders on their examination of the balance-sheet and accounts. Subsequently it was found inadvisable to confine this function to individual shareholders who might not be possessed of the requisite qualifications, and it became usual to appoint professional auditors to act on behalf of the shareholders generally."

In discussions of this subject a statement by the late Professor Dicksee is sometimes quoted to the effect that the object or scope of an audit may be defined as threefold: (1) detection of fraud; (2) detection of technical errors; (3) detection of errors of principle.

This language, however, occurs in the course of a discussion on auditing in its broadest sense, and when an accountant is specifically employed to make a complete internal audit it is, I think, applicable. It is, however, I suggest, wholly inappropriate in relation to audits under the companies acts. Indeed, Professor Dicksee goes on to say quite correctly: "The extent of an auditor's duties depends entirely upon the express or implied contract between himself and his client."

I suggest that the scope of the official audit is rather:

1. To ascertain whether any balance-sheets or other accounts submitted to members are in accord with the books of accounts from which they would ordinarily be made up.

2. To reach by examination and enquiry a reasonably informed opinion on the question whether the books are so kept that a true and correct view of the state of the company's affairs can be obtained therefrom.
3. To determine whether the directors and officers of the company in preparing from the books the balance-sheets or other accounts and submitting them to members have dealt fairly and honestly with the members.

The duties imposed on the auditors by section 134 (1) in respect of accounts other than balance-sheets are quite indefinite. The auditors are not expressly required to examine any other accounts. If they do so they must report on them, but the nature of the report to be made is not indicated as it is in the case of the balance-sheet. Where, however, accounts are so closely related to the balance-sheet as to constitute a part of the information given to members in relation to the state of the company's affairs, the auditor will be wise to regard them for this purpose as a part of the balance-sheet.

The auditor must not form his opinion lightly, but he is not required to know everything that there is to be known about a company before he does so.

The duty imposed on the auditor has remained substantially unchanged from the enactment of the companies act of 1862 (table A) to the present time: there is nothing to indicate that in the intervening seventy years the conception of the rôle of the members' auditor has been materially changed. It may be noted, however, that changes such as the substitution of the word "report" for the word "certify" do not suggest any enlargement of the auditor's obligation.

No one would propose that in the case of large undertakings the auditors, as an incident to the determination of the state of the company's affairs, should undertake to duplicate the work done by the internal auditing department of the company. The law makes no distinction between large and small companies and the only interpretation of the act capable of general application is that it leaves the responsibility for the internal audit to the directors and their appointees.

It is quite true that in the case of small companies the maintenance of an elaborate organization such as would afford adequate internal checks might involve undue expense, and it is doubtless generally true that in such cases economy and efficiency can best

be combined by arranging for continuous or frequent checks of the accounts by professional accountants. Moreover, the most convenient and economical course for the directors to adopt will usually be to retain for such a purpose the professional accountants who act as statutory auditors of the company. But I submit that there is a clear distinction between the work done by the accountants upon the instructions of the directors, practically as a part of the internal machinery of the company, and the work which falls to them as statutory auditors. If in such a case a defalcation occurs and escapes detection, questions may arise concerning the liability of the auditors. The first will be whether there is any liability in respect of their position as statutory auditors or whether the liability arises from their employment by the directors.

In my view the question of defalcations arises in connection with the official audit only incidentally in cases where one effect of the defalcation is that the balance-sheet (or an account so related thereto as to come within the scope of the auditors' report) is incorrect to a material extent, as, for instance, where debts carried as assets have in fact been collected and the proceeds appropriated by the defaulter.

In considering the position of a statutory auditor in relation to a defalcation, the vital question would seem to be whether a reasonable enquiry into the state of the company's affairs would have disclosed the over-statement and consequently the defalcation. If so, the auditor will no doubt be liable for the consequence of his failure to detect the over-statement of assets, but the question will still remain how far the fact that if he had done so further defalcations might have been prevented can properly be taken into account in assessing damages against him.

It is difficult to see how any claim could be asserted where the defalcations have been covered up in charges to expenses accounts so that the assets are not overstated and where the profit-and-loss account shows a single figure of profit "after deduction of all losses and expenses."

The extent of the auditors' liability arising out of employment by the directors will turn on the nature of their contract.

A number of cases in which claims against auditors for non-discovery of defalcations were based on their contract of employment have been before the courts, but I know of no case in which such a liability has been asserted against an auditor in respect of his purely statutory duties under the companies act.

We are all familiar with the language in the decisions in the *London and General Bank* case and the *Kingston Cotton Mills* case. In those cases the auditors had been misled into making reports in which, as subsequently appeared, the assets were grossly overstated—a matter upon which they were required by the express terms of the act to report. When it is recalled that even upon this issue the court used such language as:

"He is justified in believing tried servants of the company in whom confidence is placed by the company";

"He is entitled to assume that they are honest and to rely upon their representations provided he takes reasonable care";

"Auditors must not be made liable for not tracking down ingenious and carefully laid schemes of fraud when there is nothing to arouse their suspicion and when these frauds are perpetrated by tried servants of the company and are undetected for years by the directors";

"Where there is nothing to excite suspicion very little enquiry will be reasonable and sufficient and in practice I believe business men select a few cases haphazard, see that they are right and assume that others like them are correct also";

it would seem safe to assume that the court would not hold an auditor to a higher standard of responsibility in respect of duties which are not mentioned in the act and the assertion of which is an attempt greatly to extend by inference the express requirements of the act and to transfer to the appointees of the members, duties and obligations which naturally and logically attach to the directors and those appointed by them.

I should not like it to be thought for a moment that in my view a statutory auditor need feel no concern as to the degree of efficiency of the protection afforded by the company's methods against defalcations by employees or that he should take no steps to satisfy himself that the system is being carried out in practice. On the contrary, an auditor, even if undertaking nothing more than the official audit, should always examine the methods of control and test their working before he accepts the books as a basis for a balance-sheet which he proposes in his report to approve as exhibiting a true and correct view of the state of the company's affairs. An auditor who had signed a balance-sheet which had been proved to be substantially incorrect and sought to defend himself on the ground that the balance-sheet was in accordance with the information and explanations secured by him and was as shown by the books of the company would find his

defence gravely compromised if it were demonstrated that the accounting methods and control of the company were so lax and inadequate that no reliance could properly be placed upon the books.

Not only so, but while the auditor may properly refuse to accept a pecuniary responsibility which does not justly attach to his work, he has (if, as is now customary, he is a professional accountant) an obligation to make his work as valuable to his clients as possible within the limits of his appointment. His expert survey of the methods employed and the moral effect of intelligent tests of the working of the system, restricted though those tests may be, will exercise a valuable deterrent influence. I believe that the purpose of the modern criminal law is to act as a deterrent, the punishment of the individual being regarded as necessary to this purpose rather than retributive. No one denies, just because crimes are still committed, that the law and the police have such an effect nor can the deterrent effect of audits be denied because defalcations still occur.

The correct view of the relation of the shareholders' audit to the question of defalcations by employees is, I suggest, that it has this by no means inconsiderable preventive value, but it involves no sort of guaranty nor any undertaking to be responsible for the consequences if in a particular case such an audit neither prevents nor discloses a defalcation. It should not be relied on to disclose defalcations except so far as discovery would be a natural result of any reasonably adequate enquiry into the state of the company's affairs. If the directors desire further protection in the form of supplementary service by the auditor, the extent of the protection and the corresponding liability become matters of contract.

In the United States I believe there is no official audit, but the question of the scope of an examination sufficient to warrant a report by auditors, somewhat similar to that called for by our statute, has received considerable attention in recent years. As early as 1917, the question what examination was sufficient to justify certificate of a balance-sheet for credit purposes was considered by the federal trade commission (a body somewhat analogous to the board of trade) and by the federal reserve board (which supervises the federal banking system) and a pamphlet was issued by the latter body in that year and was revised in 1929. During the current year the New York stock exchange has

indicated that it regards the scheme of examination outlined in that pamphlet as justifying certification of the balance-sheet for submission to shareholders. It is interesting to note that in the first paragraph of this pamphlet it is stated that the procedure outlined "will not necessarily disclose defalcation," so that apparently the view in America is that an examination which is not sufficiently extensive to ensure the disclosure of defalcations may be entirely adequate as a basis for reporting to shareholders whether a given balance-sheet exhibits a correct view of the financial position of the company. Anyone who has read the pamphlet will, I am sure, share that view.

What, then, should be the nature of the contract between the company and the auditor? Obviously, there must be a wide range in the scope of usefulness of the professional auditor in varying circumstances. The principal determining factors are, perhaps, the size and number of individual transactions and the extent of the internal audit. A company with a small staff entering into a relatively small number of important transactions may prudently instruct the auditor to make the most complete verification possible. Conversely, a company with a large staff, entering into a larger number of relatively small transactions, should rely mainly on a proper subdivision of work and internal audit and ask the auditor to do no more than to satisfy himself thoroughly of the theoretical effectiveness of the internal system and make such tests of its practical working as will convince him that it is being made effective in practice. Between these limits varying degrees of completeness in the work of the auditor may be appropriate.

Naturally the fee and the degree of responsibility assumed must both vary as the audit is more or less extensive. And on this point I should like to say a word of caution to the practising accountant and especially to those beginning practice.

We sometimes hear complaints that after a defalcation has been discovered clients take a view of the extent of the work which the auditor should have performed which is far more comprehensive than that which they took when instructing him and arranging the fee. The auditor should avoid the corresponding unfairness of leading his client to expect a greater degree of protection than the procedure he proposes to adopt will in reality afford. Today, the value of the work of auditors is too highly appreciated for it to be excusable for the auditor to emulate the share-pusher and at-

tribute to his work a value greater than it can be expected to possess.

However extensive his work, an auditor should not be expected to agree to assume a pecuniary responsibility for losses which might have been avoided had he discovered a defalcation which for a time escapes detection, without regard to the amount of the loss or to the ingenuity of the methods employed by the defaulter or to the fact that the directors or employees of the company may by their acts or negligence have contributed to the successful concealment of the irregularities.

This is essentially a risk to be covered by an insurance, the amount of which is predetermined and the cost or premium commensurate with that amount. The audit should greatly reduce the risk and therefore the necessary premium, but it should not be regarded as in the nature of insurance or reinsurance.

It is an entirely mistaken notion, which is, however, held by some people, that an auditor is legally liable for the amount of any defalcation which occurs after the date of an audit at which he might have discovered that one was being perpetrated, without regard to the difficulties of detection or to the extent to which the directors may have contributed to the loss by their acts or negligence. No cases involving this question have, I believe, reached the higher courts, but in the *London Oil Storage Company* case (1904) it was considered very carefully. That case was tried by Lord Alverstone, and Mr. Rufus Isaacs (now Lord Reading) was counsel for the auditor. The neglect complained of was failure at any time to verify a petty-cash balance which over a period of years had increased from about £100 to nearly £800. It was thus a step which might be regarded as incidental to a determination of the state of the company's affairs. The auditor was appointed under the articles of association, which were rather more stringent than the provisions of the present statute. In his charge to the jury, the lord chief justice said:

"The conduct of the directors is no answer to any breach of duty by the defendant, but it is a circumstance you must take into consideration, because if you are of opinion that the loss was occasioned by a man stealing the money in consequence of there being a want of proper control over him, then the fact of there being a breach of duty by the auditor is what we lawyers call a 'causa Causans' which contributed to but would not be the cause of the loss. I do not know that I ever remember a question the solution of which was more difficult in the concrete. It is easy to

put it in general terms: Was he guilty of breach of duty, and if so, what loss was occasioned to this company by that breach of duty? You must not put upon him the loss by reason of theft occurring afterwards or before, but you must put upon him such damages as you consider in your opinion were really caused by his not having fulfilled his duty as auditor of the company."

The jury found that there was a breach of duty extending over four years, but they assessed the damages at only five guineas, adding that they considered the directors to have been guilty of gross negligence. In the course of the subsequent discussion of the judgment to be entered, the lord chief justice said:

"It was not a case in which Mr. Hasluck had said (as he might have said quite honorably, I think): 'My clerk was careless but the directors so acted that it caused the company no damage.' If that had been the way the case had been fought, I think Mr. Isaacs' contention would have been unanswerable, and that the action ought not to have been brought."

In one of the decisions of our court of appeal which I have already quoted the following sentence occurs:

"If there is anything calculated to arouse suspicion he should probe it to the bottom, but in the absence of anything of that kind he is only bound to be reasonably cautious and careful."

I have been surprised to find this language interpreted as meaning that when once an auditor's suspicions are aroused he must as a part of his statutory duty and without special compensation continue his investigations until he has found the truth, however deeply it may be buried.

I do not think that many clients would take such a view. Most of them would, I feel sure, be appreciative of the vigilance of the auditor which had resulted in discovering the defalcation and be content themselves to bear the expense of investigating its extent and its effect on the state of the company's affairs. In any case it is satisfactory to find that Lord Alverstone lent no support to the exaggerated view of the auditor's duty, for, after quoting the language above cited, he said:

"And apart from the circumstances of this case, I think Mr. Hasluck made an answer which shows that he appreciated his duty when he said, 'Had I any reason to think that the amount of cash retained at the city office was too much, I should have gone to the directors and asked for an explanation: that would have been my duty'; and so far as I may express an opinion, I think that is a true view of what his duty would have been under the

statute and the articles. He ought if his suspicion was aroused by anything that was called to his attention, to have gone to the directors and asked for an explanation."

Some years ago an interesting American case was reported in the *Accountant.* The auditors of a New York stockbroker's firm receiving an annual fee of not more than $2,000 were sued for damages and at the end of the trial the judge finally left to the jury two questions:

(1) Were the defendants negligent in the performance of their agreement, and (2) If so, what damages to the plaintiffs resulted directly and proximately from such negligence? The first question was answered in the affirmative, and to the second the jury answered "$1,177,805.26."

Afterwards, however, the court set aside the answer to the second question and directed a verdict in favor of the plaintiffs in the amount of $2,000. Upon appeal, the appellate division of the state of New York, by a majority of three to one, sustained the decision of the lower court, and in doing so, said with regard to the damages of $1,177,805:

"We think the damages can not be said to flow naturally or directly from defendants' negligence or breach of contract. Plaintiffs should not be allowed to recover for losses which they could have avoided by the exercise of reasonable care."

The Court of Appeals of New York, a court which I believe possesses an authority in America only less than the Supreme Court of the United States, unanimously confirmed the decision of the Appellate Court.

Quite recently, the court of appeals of Manitoba gave a decision in an extremely interesting case (*International Laboratories Limited* v. *Dewar et al*). In the court of first instance the judge made a number of decisions adverse to the auditors which, if they had been sustained, would, I think, have made a complete reconsideration of the legal position of auditors inevitable.

The company was a subsidiary with no stockholders except the holding company, and the audit arrangements had been made by correspondence with the officers of the holding company and confirmed by those of the subsidiary. The auditors had undertaken a restricted audit, after warning their clients of the risks such restriction entailed. The loss was covered by insurance, and it was admitted that the suit was brought in the interest of insurers. The defalcations were ultimately discovered by the auditors, who

were instructed by the company to investigate the records and determine the amount stolen.

The trial judge, that is, the judge of the court of first instance, dismissed the correspondence from consideration, holding that it was ineffectual to relieve the auditors of a duty which was imposed on them by the statute, the proper performance of which would, in his view, have resulted in the prompt discovery of the defalcations in the first year in which they occurred, that the auditors were consequently liable for the amount of all subsequent defalcations and that the insurers were entitled to recover upon the principle of subrogation. How extreme were his views on the responsibility of auditors may be judged from a single sentence quoted from his decision:

"When the defendants assumed their duties and continued to carry them out from year to year, the necessity for special vigilance by the plaintiff as against its employees was removed."

Fortunately for the profession, and as I think, for the business world also, the appeal court disagreed with the trial judge on his law as well as on his interpretation of the evidence. With one dissentient out of five judges, that court completely reversed the decision of the court below and decided the issues in favor of the auditors, both on the claim and the counter-claim for services in investigating the thefts. The dissenting judge would have found for the plaintiff on certain items constituting about one-third of the total claim.

All of the judges founded their decisions on the contract created by the correspondence. With the exception noted, all agreed that there was no breach of duty under that contract. Since this conclusion disposed of the case, all further observations are in the nature of obiter dicta. Nevertheless, it seems worth while to quote the two following excerpts:

"The liability sought to be imposed on the defendants is, in this view, based on the failure of the defendants to protect the plaintiff from its own negligence." (Trueman, J. A.)

"There is a certain minimum of control which every firm is bound to exercise over the operations in its office and which the auditors will properly assume to have been exercised." (Prendergast, C. J.)

I do not think that the burden placed on the auditor is unreasonable, in theory, even under a contract express or implied that required from him far more than the official audit. He is

required to display only reasonable skill and reasonable diligence: he is not liable merely because he fails to discover a most ingenious fraud and if the primary cause of the loss is negligent administration, his liability will, in law, be relatively small. What, then, are the reasons that make the question of liability a serious one?

The first is that, as stated by Lord Alverstone in the passage which I have already quoted, it is easier to define the auditor's liability in general terms than to deal with the question concretely. Consequently, the auditor is in the hands of a jury, and unless their decision is quite unreasonable it will not be interfered with. The second is that the question whether a fraud might have been discovered by reasonable skill and diligence is apt to take on a very different color when the fraud has, in fact, been discovered and the means by which it might have been unearthed earlier have become apparent. It is too much to expect of jurymen that they should be able to put themselves back into the position of the auditor before the discovery had been made. In the third place, the question what constitutes reasonable skill and diligence is always a difficult one. The courts have indicated that such a question can best be answered by ascertaining whether other skilled persons would have regarded the procedure actually followed as adequate or whether they would have done something more which would have prevented or reduced the loss. It is easy to be wise after the event, and an expert may be prone to think that he would have done what as it turns out would have been effective; or, on the other hand, he may find it embarrassing to say that he would have done something which another expert, whom he regards as equally competent, did not do. Answers to hypothetical questions after the event are not a very satisfactory basis on which to have to depend for a decision whether a loss which may be disastrous is to fall upon an auditor.

Undoubtedly, however, the consideration which adds most to the seriousness of the question of the liability of an auditor is that he has much more to lose than the person asserting the claim against him and that claimants can not fail to be aware of this fact. The mere fact that a suit for negligence is brought against him is apt to prove injurious whatever the outcome may be; and, if he loses, the damages and costs may be out of all proportion to any compensation he has ever received. There is no doubt that recognition of these facts has led to claims being made and paid

that could scarcely have survived scrutiny in a court of law. It follows, I think, from the foregoing that the remedy for unsatisfactory conditions lies not in changes of the law but mainly in ourselves. If we are careful what contracts, express or implied, we enter into; if we do our work with reasonable competence and diligence; if we make up our minds to face the trouble and annoyance which resistance to unfounded claims will sometimes entail, we have little to fear.

I think, however, that the organized bodies of the profession should do something to place the relations between clients, insurers and auditors on a more satisfactory footing. In the Manitoba case which I have mentioned, Mr. Justice Robson said:

"Much has been said about subrogation and suggestion that the insurers now have a right through plaintiff against defendants. I fail to see anything of the sort in the relationship of the parties."

If this is not the legal position in England steps should be taken to make it so, and I should suppose that this could readily be accomplished by appropriate wording in contracts of insurance.